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SUBJECT: Deputy Secretary Lew's Meeting with Afghan Finance Minister Zakhilwal

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SUMMARY  
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¶1. (SBU) In an April 4 meeting with Afghan Finance Minister Zakhilwal, Deputy Secretary of State for Management and Resources Jacob Lew stressed the need to demonstrate accountability as U.S. assistance to Afghanistan increases. Zakhilwal agreed, said Afghanistan has made progress on this, and that donors should reward the progress by channeling more aid through the central government budget. Such assistance could be made conditional on improved Afghan transparency and accountability. Zakhilwal said his main focus is strengthening revenue collection and that he is instituting a policy of zero tolerance for corruption at the Ministry of Finance (MOF). He requested U.S. assistance in increasing transparency, including to strengthen the government's internal audit function. Deputy Secretary Lew welcomed Zakhilwal's efforts as helping to show good GIROA management of new resources. The two agreed Afghan-Pakistan transit trade issues could be a topic for the upcoming trilateral conference. End Summary

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AID FLOWS AND ACCOUNTABILITY  
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¶2. (SBU) Deputy Secretary Lew opened the meeting saying the U.S. was at a critical moment as it transitions from developing the new strategy for Afghanistan to implementing it. As increased resources begin to flow, the U.S. needs to demonstrate that they are being used accountably. Finance Minister Zakhilwal agreed that how resources are spent is a key issue. The priorities of donor countries, he lamented, are often not those of the GIROA, especially at project- or program-level. As a result, these projects are not benefiting the people of Afghanistan in a meaningful way. (Comment: USAID has aligned its assistance programs with the Afghanistan National Development Strategy and coordinates regularly on project design and implementation. End comment.) Zakhilwal said project selection and mode of delivery are both issues. The GIROA seeks to empower and strengthen Afghan institutions, but donors channel too little of their aid through the Afghan central budget to accomplish this. Afghan accountability has improved, and donors should reward this progress -- even if it is still below their expectations. Lew said it is in the U.S. interest to build Afghan institutions and in

no one's interest for Afghanistan to be permanently reliant on foreign aid. But realistic expectations are needed as we also do not want to overload those institutions. The U.S. tries to find a balance; USAID is channeling an increased level of assistance through the central budget.

13. (SBU) Zakhilwal cited the ministerial changes at Commerce, Interior and Agriculture as positive for good stewardship of donor funds. The change at Interior, in particular, resulted from donor pressure. Pressure should continue and be rewarded when it brings positive change, as reward will encourage further reform. DepSec Lew said the U.S. Strategic Review represents change. For example, the USG plans to increase investments in agriculture and must work with the Ministry of Agriculture on operational details to get results and build a regional focus. Other donors will also increase agricultural aid, and we need to ensure coordination, including tracking and auditing of increased resource flows. The Deputy Secretary said President Karzai is interested in an Implementation Working Group, and that Secretary Clinton supports its early establishment. USAID Afghanistan/Pakistan Task Force Director Bever urged that the Finance Ministry play a role in this Working Group because of its control of the purse.

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FIGHTING CORRUPTION TO  
INCREASE GOVERNMENT REVENUES  
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14. (SBU) DepSec Lew said the USG also wants to support Afghan efforts to increase revenues. Zakhilwal said his number-one focus is strengthening revenue collection. The GIROA has already made progress since he became minister in February, and he will institute

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new measures, including a policy of zero tolerance for corruption. The government can double the current level of revenue collection and exceed IMF targets. Zakhilwal sought U.S. support, both equipment and training, to strengthen local finance offices (mustufiat) and MOF's Internal Audit Unit.

15. (SBU) Zakhilwal also promised efforts on the spending side of the budget and described his efforts to cut fraud in public contracting. He said Afghanistan has good procedures on paper, but they are often subverted in practice, and MOF's Internal Audit Unit needs to do a better job at investigating discrepancies. For example, a call for competitive bids on a contract is published in the newspaper, but some interested party buys up all the papers that day. Also, although MOF is responsible for internal auditing government-wide, the legal provision granting that authority has been suspended at the request of the Auditor General through the President. DepSec Lew agreed enforcement of rules is critical. Violators must be prosecuted and/or barred from further bidding. Internal audit is also critical and should be strengthened. As background, DepSec Lew noted as positive the fact that U.S. programs in Afghanistan are scrutinized at three levels: the General Accounting Office, inspectors general in each agency, and the Special IG for Afghan Reconstruction.

16. (SBU) Zakhilwal described MOF's fraud hotline, which the public and business community can use to complain about corruption. He said he gets personally involved in following up on complaints. In one case, an MOF Tax Department official was caught in a sting for demanding a bribe from a company seeking certification that it was current on its taxes. Zakhilwal said he intends to prosecute individuals caught taking bribes.

17. (SBU) Zakhilwal also requested aid to increase revenues collected by other ministries, e.g. vehicle registration fees collected by Interior and civil aviation navigation fees collected by the Ministry of Transport and Civil Aviation. Both of these ministries are cooperating, he said. In MOI's case, the ministry would get to keep some of the additional revenue generated. There is potential for increased revenue at the ministries of Power and Water and Mines too, but they are not cooperating. As a result, the cabinet decided MOF will lead a review of all mining contracts concluded (except the Aynak copper mine, the largest of them all) to see if the GIROA is

raising all the revenue it should.

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AID EFFECTIVENESS  
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¶8. (SBU) DepSec Lew said Zakhilwal's efforts are very encouraging and should help the US show good GIROA management of new resources. Zakhilwal also described the Aid Coordination Unit at MOF and asked for equipment and technical assistance to strengthen it. The government has also asked donor agencies to designate an Afghan employee to provide continuity for aid reporting purposes. DepSec Lew said USAID has done this.

¶9. (SBU) Zakhilwal reiterated his call for channeling more aid, whether discretionary or donor-preferenced, through the central budget and said this could be made conditional on improved Afghan transparency and accountability. He also called for a greater GIROA role in project impact evaluations. USAID Mission Director Yates said GIROA reps participate in USAID's procurement panels and should also join impact evaluation teams. DepSec Lew said the U.S. would consider direct budget support and that a proposal was under consideration in Washington but that this was often difficult.

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BORDER ISSUES  
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¶10. (SBU) In response to DepSec Lew's question, Zakhilwal reviewed Afghan traders' complaints with Pakistani implementation of the current bilateral Transit Trade Agreement. He said the GOP ban on transshipping goods from India was mainly economically motivated, even though the GOP always cited political/security issues. DepSec

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Lew said the new Trilateral Commission should take up these issues. While escorting Zakhilwal out after the meeting, Emboffs raised the issue of longer opening hours for Customs houses along the Pakistan border to facilitate the coming increase in U.S. military shipments. The minister said the government was looking into this but had not yet discussed it with GOP counterparts. The Embassy is following up.

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COMMENT  
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¶11. (SBU) Zakhilwal's willingness in principle to accept conditions to ensure transparency and accountability of any new U.S. direct budget support is an opening the USG should seize. In this connection, the Mission supports the proposed Cash Transfer Program under consideration in Washington and is prepared to help develop policy reform benchmarks that this assistance could be designed to promote. The Mission also strongly supports taking up Af-Pak transit trade issues as one of the key economic agenda items in the Trilateral Commission.

¶12. (U) D(L) staff cleared this cable.

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